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MEMORANDUMRECEIVED
AZ CORP COMMISSION
DOCKET CONTROL

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

2015 FEB 27 PM 3 24

ORIGINAL

DATE: February 27, 2015

RE: **SUPPLEMENTAL STAFF REPORT** IN RESPONSE TO NAVAJO WATER COMPANY, INC.'S FILING OF COMMENTS TO THE ORIGINAL STAFF REPORT REGARDING ITS APPLICATION FOR A RATE INCREASE (DOCKET NO. W-03511A-14-0304)


Staff files this Supplemental Staff Report in response to Navajo Water Company, Inc.'s comments to the original Staff Report filed December 24, 2014. Staff recommends approval of the rate increase application using Staff's recommended Supplemental rates and charges.

SMO:BAB:nr\RRM

Originator: Briton A. Baxter

Arizona Corporation Commission
DOCKETED

FEB 27 2015

DOCKETED BY 

Service List for: Navajo Water Co., Inc.
Docket No. W-03511A-14-0304

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**SUPPLEMENTAL STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

NAVAJO WATER COMPANY, INC.


DOCKET NO. W-03511A-14-0304

**APPLICATION FOR
A PERMANENT RATE INCREASE**

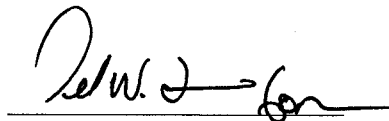
FEBRUARY 27, 2015

STAFF ACKNOWLEDGMENT

The Supplemental Staff Report for Navajo Water Company, Inc. ("Company"), Docket No. W-03511A-14-0304 was the responsibility of the Staff members listed below. Briton A. Baxter was responsible for the financial review and analysis of the Company's application. Katrin Stukov was responsible for the engineering and technical analysis.

A handwritten signature in cursive script, appearing to read "Briton A. Baxter", written over a horizontal line.

Briton A. Baxter
Public Utilities Analyst IV

A handwritten signature in cursive script, appearing to read "Katrin Stukov", written over a horizontal line.

Katrin Stukov
Utilities Engineer

**SUPPLEMENTAL EXECUTIVE SUMMARY
NAVAJO WATER COMPANY, INC.
DOCKET NO. W-03511A-14-0304**

Navajo Water Company, Inc. ("Navajo" or "Company") is a Class D water utility that provides potable water service to approximately 305 customers. The Company's three water systems are located around the City of Show Low in Navajo County, Arizona.

The Company proposed rates would increase revenue by \$69,627 or 70.16 percent over test year revenues of \$99,246 to \$168,873, which would result in an operating income of \$15,628. This equates to a 12.00 percent rate of return on the Company-proposed fair value rate base ("FVRB"), which is also its original cost rate base ("OCRB"), of \$130,225. The Company's proposed rates would yield a positive cash flow of \$30,539. Under the Company-proposed rates, the typical residential monthly bill (all test year customers had a 5/8 x 3/4-inch meters), with median use of 1,761 gallons, would increase from \$22.35 to \$39.60, an increase of \$17.25 or 77.2 percent.

Staff recommends rates that would increase revenue by \$67,341 or 67.85 percent over test year revenues of \$99,246 to \$166,587, which would result in an operating income of \$11,778. This equates to a 10.00 percent rate of return on Staff's adjusted OCRB of \$117,816. Staff's recommended rates would yield a positive cash flow of \$34,397. Under the Staff-recommended rate design, the typical residential monthly bill, with median use of 1,761 gallons, would increase from \$22.35 to \$35.22, an increase of \$12.87, or 57.6 percent.

Staff recommends:

1. The Commission approve the Staff-recommended rates and charges as shown in Supplemental Schedule BAB-4.
2. That in the future, the Company should be charged directly for all expenses which are already being tracked separately, such as the salaries and wages of the two system operators, chemicals, water testing, bad debts, etc. rather than these expenses being included in the management fee/allocation.
3. The Company use a 4-factor allocation to charge indirect costs.
4. The new rates approved in this case not be effective until the first day of the month after the Company files with Docket Control, as a compliance item in this docket, documentation from Arizona Department of Water Resources ("ADWR") indicating that Navajo's three water systems are compliant with departmental requirements governing water providers and/or community water systems.
5. The depreciation rates listed in Table B of the Engineering report.
6. Approval of the Best Management Practices ("BMPs") included in attachment A. Staff further recommends that the Company notify its customers, in a form acceptable to Staff, of the BMP tariffs authorized in this proceeding and their effective date by means of either an insert in the next regularly scheduled billing or

by a separate mailing and shall provide copies of the BMP tariffs to any customer, upon request. The Company may request cost recovery of actual expenses associated with the BMPs implemented in its next general rate application.

7. The Company file with Docket Control as a compliance item in this docket, within sixty days of the effective date of the order in this matter, its Summer Pines 40,000 gallons storage tank replacement plan. Staff further recommends that the Company install Phase One and file with Docket Control as a compliance item in this docket within six months of the effective date of the order in this matter, a copy of the ADEQ Approval of Construction for the Summer Pines first storage tank with a minimum capacity of 20,000 gallons. Staff further recommends that the Company install Phase Two and file with Docket Control, as a compliance item in this docket within 12 months of the effective date of the order in this matter, a copy of the ADEQ Approval of Construction for the Summer Pines second storage tank with a minimum capacity of 20,000 gallons.

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BACKGROUND

On August 15, 2014, Navajo filed an application for a permanent rate increase with the Arizona Corporation Commission ("Commission"). Staff issued a Letter of Sufficiency on October 10, 2014.

On December 24, 2014, Staff filed a Staff Report recommending approval of the rates and charges shown in Schedule BAB-4, of that Report.

COMPANY'S COMMENTS TO THE STAFF REPORT

On February 11, 2015, Navajo filed comments to the Staff Report. In its comments, the Company focused on the following aspects of the Staff Report:

1. Staff's adjustment to decrease Salaries and Wages expense.
2. Staff's recommended Property Tax expense.
3. Staff's recommendation that Navajo be required to file five BMP tariffs.
4. Staff's recommended timeline to replace the Summer Pines storage tank due to Staff not offering any financial mechanisms to pay for the replacement.

A procedural conference was held on February 20, 2015 at which time Staff indicated that it would file a response to the Company's comments by February 27, 2015.

STAFF'S RESPONSE TO THE COMPANY'S COMMENTS

1. Salaries and Wages Expense

Company's Comments: Page 1, Salaries and Wages Expense states, "Staff's Adjustment A decreases salaries and wages expense by \$15,738, from \$15,738 to \$0 as shown on Supplemental Schedule BAB-3, pages 1 and 2. Staff reasoned that because salaries and wages are included in the administrative fee of \$13.31 per customer per month charged as an outside service, including an allocation for salaries would result in a "double counting" of these expenses. Staff is in error."

Navajo's salaries and wages expense reflects the actual hourly wages for operations, and the management contract between JW Water Holdings and the Company does not cover or include direct operations expense. The monthly management fee of \$13.31 per customer per month includes management salaries only.

Staff Response: Based on the Company's comments, and further discussions with the Company, Staff has reconsidered its original salaries and wages adjustment and now recommends a decrease in salaries and wages expense of \$6,489, from \$15,738 to \$9,249. The Company stated that the salaries and wages expense as reported in the application was for the actual time spent operating each system. However, as shown in the support for salaries and wages included with the Company's application, the \$15,738 in expenses equated to 15.07 percent of the \$104,408 in total salaries and wages for the two operators and an office administrator. Staff's adjustment reflects the actual time

spent by the two system operators working specifically on the Navajo system with an allocation using the recommended 4-factor allocation as shown on Supplemental Schedule BAB-3 page 5 for the time not specifically tied to a system such as vacation time, sick time or holidays. Per the Company's statement that the administrative fee includes management salaries, the \$3,638 that was allocated to Navajo for administration salaries has been removed from salaries and wages so it is not being double counted.

2. Property Tax Expense

Company's Comments: Navajo states (on page 2), "Staff adjustment H decreases property tax expense by \$1,549, from \$4,239 to \$2,690, as shown on Schedule BAB-3, pages 1 and 4. This adjustment reflects Staff's recalculation of property tax expense. The Company has found that Staff's property tax expense is understated because Staff used an incorrect effective property tax rate of 7.326 percent." Navajo's effective property tax rate is 11.6386 percent as shown in Exhibit 1.

Staff Response: In speaking with the Company's utility accountant, Tom Bourassa, Staff agrees that an incorrect effective property tax rate was used in the original Staff report. Staff agrees with the rate that the Company used and the resulting property tax expense of \$4,239 as proposed in the Company's application, therefore no adjustment is necessary to test year property tax expense. Staff concludes that adjustment H in the original Staff report is unwarranted, as shown on Surrebuttal Schedule BAB-3, page 1.

3. BMP Tariffs

Company Comments: Navajo believes that the BMP recommendation should be rejected entirely on the grounds that the Company is not located within an Active Management Area and that they are a very small water company struggling to pay its bills without the available revenue to fund Staff's recommendations. Further, the Company argues that the Commission has been consistently rejecting recommendations by Staff to impose BMPs because among other reasons, overregulation and cost.

Staff Response: Staff continues to recommend approval of the BMPs included in attachment A to the Staff Report.

4. New Storage Capacity

Company's Comments: Navajo agrees with Staff that the Summer Pines 40,000 gallon storage tank will soon require replacement. However, the Company argues that Staff does not propose any financial mechanisms in the recommendation to pay for the costly upgrade and the Company cannot fund the upgrade within the recommended timeline without causing financial distress. Therefore, the Company proposes an alternative phased-in plan as follows:

- File with Docket Control as a compliance item in this docket, within six months of the effective date of the order in this matter, a replacement plan for its Summer Pines storage tank.

- Install phase one within nine months of the effective date of the order. Phase one would include 20,000 gallons of storage operating in conjunction with the existing storage tank as a temporary measure.
- Install phase two within 18 months of the effective date of this order. Phase two would include an additional 20,000 gallons of storage, and removal of the existing tank, and receipt of the final ADEQ approval. (emphasis added)

The Company's proposed plan would also allow the Company to apply to WIFA for an engineering design assistance grant for the plans and specifications necessary to apply to ADEQ for the necessary approvals.

Staff Response: Due to the condition and subsequent safety implications of the Summer Pines 40,000 gallons storage tank, Staff believes that the replacement of this tank should be a high priority for the Company. Staff is in agreement with the Company's proposed phase-in of the tank replacement; however, Staff recommends that the time period be expedited. Staff recommends the following:

- File with Docket Control as a compliance item in this docket within sixty days of the effective date of the order in this matter its Summer Pines 40,000 gallons storage tank replacement plan.
- Install Phase One and file with Docket Control as a compliance item in this docket within six months of the effective date of the order in this matter, a copy of the ADEQ Approval of Construction for the Summer Pines first storage tank with a minimum capacity of 20,000 gallons. Phase One would operate in conjunction with the existing 40,000 gallons storage tank as a temporary measure.
- Install Phase Two and file with Docket Control as a compliance item in this docket within twelve months of the effective date of the order in this matter, a copy of the ADEQ Approval of Construction for the Summer Pines second storage tank with a minimum capacity of 20,000 gallons.

STAFF ANALYSIS, CONCLUSION AND RECOMMENDATION

Rate base

Adjustment D decreases cash working capital by \$1,017 from \$14,762 to \$13,745 as shown on Supplemental Schedule BAB-2, page 1. This is an increase of \$1,156 over what was recommended in the original Staff Report due to salaries and wages and property tax expenses being understated by Staff in the original Staff Report. The total rate base is increased by the same amount to \$1,156.

Staff Recommended Operating Revenue

Staff recommends total operating revenue of \$166,587, an increase of \$67,341, or 67.85 percent above test year revenue of \$99,246. This is an increase of \$12,319 over what was recommended in the original Staff Report.

The Company continues to propose total operating revenue of \$168,873 as shown on Supplemental Schedule BAB-1.

Rate Design

Supplemental Schedule BAB-4 presents a complete list of the Company's present, proposed, and Staff's recommended rates and charges.

The Company continues to propose the same rate design as in the original Staff Report.

The Company proposed rates would increase the typical 5/8 x 3/4-inch meter residential bill with a median usage of 1,761 gallons from \$22.35 to \$39.60, for an increase \$17.25 or 77.2 percent, as shown on Supplemental Schedule BAB-5.

Staff's recommended rates would increase the typical 5/8 x 3/4-inch meter residential bill with a median usage of 1,761 gallons from \$22.35 to \$35.22, for an increase \$12.87 or 57.6 percent, as shown on Supplemental Schedule BAB-5.

STAFF RECOMMENDATIONS

1. The Commission approve the Staff-recommended rates and charges as shown in Supplemental Schedule BAB-4.
2. That in the future, the Company should be charged directly for all expenses which are already being tracked separately, such as the salaries and wages of the two system operators, chemicals, water testing, bad debts, etc. rather than these expenses being included in the management fee/allocation.
3. The Company use a 4-factor allocation to charge indirect costs.
4. The new rates approved in this case not be effective until the first day of the month after the Company files with Docket Control, as a compliance item in this docket, documentation from ADWR indicating that Navajo's three water systems are compliant with departmental requirements governing water providers and/or community water systems.
5. The depreciation rates listed in Table B of the Engineering report.

6. Approval of the BMPs included in attachment A. Staff further recommends that the Company notify its customers, in a form acceptable to Staff, of the BMP tariffs authorized in this proceeding and their effective date by means of either an insert in the next regularly scheduled billing or by a separate mailing and shall provide copies of the BMP tariffs to any customer, upon request. The Company may request cost recovery of actual expenses associated with the BMPs implemented in its next general rate application.
7. The Company file with Docket Control as a compliance item in this docket, within sixty days of the effective date of the order in this matter, its Summer Pines 40,000 gallons storage tank replacement plan. Staff further recommends that the Company install Phase One and file with Docket Control as a compliance item in this docket within six months of the effective date of the order in this matter, a copy of the ADEQ Approval of Construction for the Summer Pines first storage tank with a minimum capacity of 20,000 gallons. Staff further recommends that the Company install Phase Two and file with Docket Control, as a compliance item in this docket within 12 months of the effective date of the order in this matter, a copy of the ADEQ Approval of Construction for the Summer Pines second storage tank with a minimum capacity of 20,000 gallons.

Navajo Water Company
W-03511A-14-0304
Test Year Ended June 30, 2014

Supplemental Schedule BAB-1

SUMMARY OF FILING

	Present Rates		Proposed	Recommended
	Company	Staff	Company	Staff
	as	as	as	as
	Filed	Adjusted	Filed	Adjusted
Revenues:				
Metered Water Revenue	\$97,782	\$97,782	\$167,409	\$165,123
Unmetered Water Revenue	0	0	0	0
Other Water Revenues	1,464	1,464	1,464	1,464
Total Operating Revenue	\$99,246	\$99,246	\$168,873	\$166,587
Operating Expenses:				
Operation and Maintenance	\$129,173	\$122,033	\$129,173	\$122,033
Depreciation	14,911	22,619	14,911	22,619
Property & Other Taxes	4,239	4,239	5,230	7,115
Income Tax	(9,865)	(10,190)	3,931	3,042
Total Operating Expense	\$138,458	\$138,701	\$153,245	\$154,808
Operating Income/(Loss)	(\$39,212)	(\$39,455)	\$15,628	\$11,778
Rate Base O.C.L.D.	\$130,225	\$117,816	\$130,225	\$117,816
Rate of Return - O.C.L.D.	N/M	N/M	12.00%	10.00%
Cash Flow	(\$24,301)	(\$16,836)	\$30,539	\$34,397

Note: N/M means that the calculation is not meaningful.

ORIGINAL COST RATE BASE

	----- Original Cost -----		
	Company	Adjustment	Staff
Plant in Service	\$443,062	\$2,227 A	\$445,289
Less:			
Accum. Depreciation	316,491	0	316,491
Net Plant	\$126,571	\$2,227	\$128,798
Less:			
Plant Advances	\$0	\$0	\$0
Meter Deposits	6,233	0	6,233
Total Advances	\$6,233	\$0	\$6,233
Contributions Gross	\$6,428	\$42,271 B	\$48,699
Less:			
Amortization of CIAC	1,050	28,652 C	29,702
Net CIAC	\$5,378	\$13,619	\$18,997
Total Deductions	\$11,611	\$13,619	\$25,230
Plus:			
1/24 Power	\$503	\$0	\$503
1/8 Operation & Maint.	\$14,762	(\$1,017) D	\$13,745
Inventory	\$0	\$0	\$0
Prepayments	\$0	\$0	\$0
Total Additions	\$15,265	(\$1,017)	\$14,248
Rate Base	\$130,225	(\$12,409)	\$117,816

Explanation of Adjustment:

- A - For Rate Base adjustment A, see Sch BAB-2, page 2
B - For Rate Base adjustment B, see Sch BAB-2, page 4
C - For Rate Base adjustment C, see Sch BAB-2, pages 4-5
D - For Rate Base adjustment D, see Sch BAB-2, page 6

PLANT ADJUSTMENT

Line No.	Acct. No.	Description	Company Exhibit	Adjustment	Staff Adjusted
1	301	Organization Costs	\$0	\$0	\$0
2	302	Franchise Costs	0	0	0
3	303	Land & Land Rights	10,050	0	10,050
4	304	Structures & Improvements	11,511	0	11,511
5	307	Wells & Springs	21,353	0	21,353
6	310	Power Generation Equipment	0	0	0
7	311	Electric Pumping Equipment	113,433	1,831 a	115,264
8	320	Water Treatment Equipment	0	0	0
9	320.1	Water Treatment Plants	0	0	0
10	320.2	Solutions & Feeders	0	0	0
11	320.3	Arsenic Remediation Plant	0	0	0
12	330	Distribution Reservoirs & Standpipes	60,347	(60,347) b	0
13	330.1	Storage Tank	0	40,231 b	40,231
14	330.2	Pressure Tanks	0	20,116 b	20,116
15	331	Transmission & Distribution Mains	123,642	0	123,642
16	333	Services	47,963	0	47,963
17	334	Meters & Meter Installations	44,561	396 c	44,957
18	335	Hydrants	0	0	0
19	336	Backflow Prevention Devices	0	0	0
20	339	Other Plant & Misc. Equip.	0	0	0
21	340	Office Furniture & Fixtures	143	0	143
22	340.1	Computer & Software	0	0	0
23	341	Transportation Equipment	0	0	0
24	342	Store Equipment	0	0	0
25	343	Tools & Work Equipment	703	0	703
26	344	Laboratory Equipment	0	0	0
27	345	Power Operated Equipment	0	0	0
28	346	Communications Equipment	1,709	0	1,709
29	347	Miscellaneous Equipment	0	0	0
30	348	Other Intangibles	7,647	0	7,647
31	105	C.W.I.P.	0	0	0
32		TOTALS	\$443,062	\$2,227 A	\$445,289

Explanation of Adjustment:

- a - For Rate Base adjustment a, see Sch BAB-2, page 3
- b - For Rate Base adjustment b, see Sch BAB-2, page 3
- c - For Rate Base adjustment c, see Sch BAB-2, page 3

STAFF PLANT ADJUSTMENT

a. Electric Pumping Equipment	Per Company	\$113,433	
	Per Staff	115,264	<u>\$1,831</u>

The Company proposed an increase of \$4,756, however, the invoices included in the application supported an increase of \$6,587, a difference of \$1,831.

b. Distribution Reservoirs & Standpipes	Per Company	\$60,347	
	Per Staff	0	<u>(\$60,347)</u>

b. Storage Tank	Per Company	\$0	
	Per Staff	40,231	<u>\$40,231</u>

b. Pressure Tanks	Per Company	\$0	
	Per Staff	20,116	<u>\$20,116</u>

The Company was incorrectly reporting storage and pressure tank investments in account number 330, instead of the more detailed 330.1 and 330.2 account numbers which are depreciated at different rates. To correctly account for the tanks, the Company stated in response to Staff DR BAB 2.18 that two-thirds of the balance of the distribution reservoirs & standpipes account are storage tanks with the remaining being pressure tanks.

c. Meters & Meter Installations	Per Company	\$44,561	
	Per Staff	44,957	<u>\$396</u>

In response to Staff DR KS1.4, the Company provided information that showed they installed four new meters at a total cost of \$396 that was not included in the application.

STAFF RATE BASE ADJUSTMENTS

B. Contributions-in-Aid-of-Construction (CIAC)

Per Company \$6,428
Per Staff 48,699
\$42,271

To reflect Staff's calculation of unsupported plant treated as CIAC.

Act. No.	Description	Unsupported Plant Costs
304	Structures & Improvements	\$3,431
311	Pumping Equipment	79,855
330.1	Storage Tank	6,104
330.2	Pressure Tanks	3,052
331	Transmission & Distrib. Mains	12,774
333	Services	178
334	Meters & Meter Installations	26,152
346	Communication Equipment	1,709
348	Other Tangible Plant	7,647
		\$140,902
		X 30%
		<u>\$42,271</u>

C. Amortization of CIAC

Per Company \$1,050
Per Staff 29,702
\$28,652

To reflect Staff's calculation of amortization of CIAC on unsupported plant.

Act. No.	Description	Year placed into service	Unsupported Plant Costs	Number of Interim Years	Depreciation Rate	Amortization of CIAC
304	Structures & Improvements	1999	\$799	14.5	3.33%	\$386
311	Pumping Equipment	1999	7,379	14.5	12.50%	7,379
330.1	Storage Tank	1999	1,754	14.5	2.22%	565
330.2	Pressure Tanks	1999	877	14.5	5.00%	636
334	Meters & Meter Installations	1999	4,697	14.5	8.33%	4,697
348	Other Tangible Plant	1999	7,647	14.5	5.00%	5,544
311	Pumping Equipment	2000	5,123	13.5	12.50%	5,123
330.1	Storage Tank	2000	408	13.5	2.22%	122
330.2	Pressure Tanks	2000	204	13.5	5.00%	138
331	Transmission & Distrib. Mains	2000	2,628	13.5	2.00%	710
334	Meters & Meter Installations	2000	2,928	13.5	8.33%	2,928
311	Pumping Equipment	2001	9,162	12.5	12.50%	9,162
330.1	Storage Tank	2001	3,749	12.5	2.22%	1,040
330.2	Pressure Tanks	2001	1,875	12.5	5.00%	1,172
331	Transmission & Distrib. Mains	2001	6,367	12.5	2.00%	1,592
334	Meters & Meter Installations	2001	6,080	12.5	8.33%	6,080
311	Pumping Equipment	2002	1,496	11.5	12.50%	1,496
330.1	Storage Tank	2002	193	11.5	2.22%	49
330.2	Pressure Tanks	2002	96	11.5	5.00%	55
331	Transmission & Distrib. Mains	2002	3,779	11.5	2.00%	869
334	Meters & Meter Installations	2002	1,295	11.5	8.33%	1,241
311	Pumping Equipment	2003	4,289	10.5	12.50%	4,289
334	Meters & Meter Installations	2003	1,991	10.5	8.33%	1,741
346	Communication Equipment	2003	1,709	10.5	10.00%	1,709
311	Pumping Equipment	2004	483	9.5	12.50%	483
334	Meters & Meter Installations	2004	707	9.5	8.33%	559
334	Meters & Meter Installations	2005	2,428	8.5	8.33%	2,428
311	Pumping Equipment	2006	7,794	7.5	12.50%	7,307
334	Meters & Meter Installations	2006	1,435	7.5	8.33%	897
311	Pumping Equipment	2007	5,595	6.5	12.50%	4,546
333	Services	2007	178	6.5	12.50%	145
334	Meters & Meter Installations	2007	2,278	6.5	8.33%	1,233
304	Structures & Improvements	2008	2,632	5.5	3.33%	482
311	Pumping Equipment	2008	5,051	5.5	12.50%	3,473
334	Meters & Meter Installations	2008	155	5.5	8.33%	71
311	Pumping Equipment	2009	17,830	4.5	12.50%	10,029
334	Meters & Meter Installations	2009	861	4.5	8.33%	323
311	Pumping Equipment	2010	7,563	3.5	12.50%	3,309
334	Meters & Meter Installations	2010	63	3.5	8.33%	18
311	Pumping Equipment	2011	541	2.5	12.50%	169
334	Meters & Meter Installations	2011	58	2.5	8.33%	12
311	Pumping Equipment	2012	5,718	1.5	12.50%	1,072
334	Meters & Meter Installations	2012	780	1.5	8.33%	97
311	Pumping Equipment	2013	1,831	0.5	12.50%	114
334	Meters & Meter Installations	2013	396	0.5	8.33%	16
						\$95,507
						X 30%
						<u>\$28,652</u>

D. WORKING CAPITAL (1/8 OPERATION & MAINT EXP)

Per Company \$14,762
Per Staff 13,745
(\$1,017)

To reflect Staff's calculation of working capital based upon Staff's recommendations for operation and maintenance expense (excluding purchased power and purchased water expenses).

STATEMENT OF TEST YEAR OPERATING INCOME

Line No.	Acct. No.	Description	[A] Company Exhibit	[B] Staff Adjustments	[C] Staff Adjusted	[D] Staff Adjustments	[E] Staff Recommended
Revenues:							
1	461	Metered Water Revenue	\$97,782	\$0	\$97,782	\$67,341	\$165,123
2	460	Unmetered Water Revenue	0	0	0		0
3	474	Other Water Revenues	1,464	0	1,464		1,464
4		Total Operating Revenue	\$99,246	\$0	\$99,246	\$67,341	\$166,587
Operating Expenses:							
7	601	Salaries and Wages	\$15,738	(\$6,489) A	\$9,249		\$9,249
8	610	Purchased Water	0	0	0		0
9	615	Purchased Power	12,072	0	12,072		12,072
10	618	Chemicals	714	(407) B	307		307
11	620	Repairs and Maintenance	10,052	0	10,052		10,052
12	621	Office Supplies & Expense	3,342	0	3,342		3,342
13	630	Outside Services	63,361	1,071 C	64,432		64,432
14	635	Water Testing	2,738	(359) D	2,379		2,379
15	641	Rents	6,033	(538) E	5,495		5,495
16	650	Transportation Expenses	5,274	(418) F	4,856		4,856
17	657	Insurance - General Liability	734	0	734		734
18	659	Insurance - Health and Life	261	0	261		261
19	666	Regulatory Commission Expense - Rate Case	5,000	0	5,000		5,000
20	675	Miscellaneous Expense	3,465	0	3,465		3,465
21	403	Depreciation Expense	14,911	7,708 G	22,619		22,619
22	408	Taxes Other Than Income	0	0	0		0
23	408.11	Property Taxes	4,239	(0)	4,239	2,876	7,115
24	670	Bad Debt Expense	389	0	389		389
25	409	Income Tax	(9,865)	(325) H	(10,190)	13,231	3,042
26		Total Operating Expenses	\$138,458	\$243	\$138,701	\$16,107	\$154,808
29		OPERATING INCOME/(LOSS)	(\$39,212)	(\$243)	(\$39,455)	\$51,233	\$11,778

STAFF ADJUSTMENTS

A	SALARIES AND WAGES - Per Company	\$15,738	
	Per Staff	<u>9,249</u>	<u>(\$6,489)</u>

Adjustment reflects Staff's removal of the allocated salaries and wages that are included in the management fee included in the outside services expense line item.

B	CHEMICALS - Per Company	\$714	
	Per Staff	<u>307</u>	<u>(\$407)</u>

Adjustment reflects Staff's use of the recommended 4-factor cost allocation method.

C	OUTSIDE SERVICES - Per Company	\$63,361	
	Per Staff	<u>64,432</u>	<u>\$1,071</u>

Adjustment reflects Staff's use of the recommended 4-factor cost allocation method.

D	WATER TESTING - Per Company	\$2,738	
	Per Staff	<u>2,379</u>	<u>(\$359)</u>

To reflect Staff's calculation of water testing expense.

E	RENTS - Per Company	\$6,033	
	Per Staff	<u>5,495</u>	<u>(\$538)</u>

Adjustment reflects Staff's use of the recommended 4-factor cost allocation method.

F	TRANSPORTATION EXPENSE - Per Company	\$5,274	
	Per Staff	<u>4,856</u>	<u>(\$418)</u>

Adjustment reflects Staff's use of the recommended 4-factor cost allocation method.

STAFF ADJUSTMENTS (Cont.) - DEPRECIATION EXPENSE

G	DEPRECIATION - Per Company	\$14,911	
	Per Staff	22,619	\$7,708

To reflect Staff's calculation of deprecation expense.

Line No.	Acct. No.	Description	[A] Utility Plant in Service Balances	[B] Fully/Non-Depreciable Plant Balances	[C] Depreciable Plant In Service	[D] Deprec. Rate	[E] Depreciation Expense
Plant In Service							
1	301	Organization Costs	\$0	\$0	\$0	0.00%	\$0
2	302	Franchise Costs	0	0	0	0.00%	0
3	303	Land & Land Rights	10,050	0	10,050	0.00%	0
4	304	Structures & Improvements	11,511	0	11,511	3.33%	383
5	307	Wells & Springs	21,353	0	21,353	3.33%	711
6	311	Electric Pumping Equipment	115,264	0	115,264	12.50%	14,408
7	320	Water Treatment Equipment					
8	320.1	Water Treatment Plants	0	0	0	3.33%	0
9	320.2	Solutions & Feeders	0	0	0	20.00%	0
10	320.3	Arsenic Remediation Plant					
11	330	Distribution Reservoirs & Standpipes	0	0	0		0
12	330.1	Storage Tank	40,231	0	40,231	2.22%	893
13	330.2	Pressure Tanks	20,116	0	20,116	5.00%	1,006
14	331	Transmission & Distribution Mains	123,642	0	123,642	2.00%	2,473
15	333	Services	47,963	0	47,963	3.33%	1,597
16	334	Meters & Meter Installations	44,957	0	44,957	8.33%	3,745
17	335	Hydrants	0	0	0	2.00%	0
18	336	Backflow Prevention Devices	0	0	0	6.67%	0
19	339	Other Plant & Misc. Equip.	0	0	0	6.67%	0
20	340	Office Furniture & Fixtures	143	0	143	20.00%	29
21	340.1	Computer & Software	0	0	0	20.00%	0
22	341	Transportation Equipment	0	0	0	20.00%	0
23	342	Store Equipment	0	0	0	4.00%	0
24	343	Tools & Work Equipment	703	0	703	5.00%	35
25	344	Laboratory Equipment	0	0	0	10.00%	0
26	345	Power Operated Equipment	0	0	0	5.00%	0
27	346	Communications Equipment	1,709	0	1,709	10.00%	171
28	347	Miscellaneous Equipment	0	0	0	10.00%	0
29	348	Other Intangibles	7,647	0	7,647	0.00%	0
30		Subtotal General	\$437,642	\$0	\$445,289		\$25,451
31							
32		Less: Amortization of Contributions			\$48,699	5.82%	\$2,832
33							
34		Staff Recommended Depreciation Expense					\$22,619
35		Company Proposed Depreciation Expense					14,911
36		Increase/(Decrease) to Depreciation Expense					\$7,708

STAFF ADJUSTMENTS (Cont.) - INCOME TAXES

H	INCOME TAX - Per Company	(\$9,865)	
	Per Staff	(10,190)	(\$325)

To reflect Staff's calculation of income tax expense.

Line No.	Description	[A]	[B]
		Staff As Adjusted	Staff Recommended
<u>Calculation of Income Tax:</u>			
1	Revenue (Schedule BAB-3, Col.[C and E], Line 4	\$99,246	\$166,587
2	Operating Expenses Excluding Income Taxes	148,891	151,767
3	Rate Base (Schedule BAB-2)	117,816	117,816
4	Weighted Average Cost of Debt	0.0000%	0.0000%
5	Synchronized Interest	0	0
6	Arizona Taxable Income (L1 - L2 - L5)	(49,645)	14,820
7	Arizona State Income Tax Rate	6.5000%	6.5000%
8	Arizona Income Tax (L6 * L7)	(\$3,227)	\$963
9	Federal Taxable Income (L6 - L8)	(46,418)	13,857
10	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	(6,963)	2,079
11	Federal Tax on Second Income Bracket (\$50,001 - \$75,000) @ 25%	0	0
12	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	0	0
13	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	0	0
14	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	0	0
15	Total Federal Income Tax	(6,963)	2,079
16	Combined Federal and State Income Tax (L35 + L42)	(\$10,190)	\$3,042

STAFF ADJUSTMENTS (Cont.) - 4-FACTOR ALLOCATION

		[A]	[B]	[C]	[D]	[E]	[F]	[G]	[H]	[I]
Line No.	Company	Customer count	Customer count %	Net Plant in service	Net Plant in service %	Operating expenses	Operating expenses %	Number of systems	Number of systems %	4-factor %
1	Navajo	301	13.16%	\$112,393	6.35%	\$80,284	9.52%	3	18.75%	11.94%
2	Payson	1,101	48.12%	962,632	54.41%	346,604	41.10%	8	50.00%	48.41%
3	Tonto Basin	886	38.72%	694,289	39.24%	416,380	49.38%	5	31.25%	39.65%
4	Total	2,288		\$1,769,314		\$843,268		16		100.00%

References:

Column [A]: The Customer counts are from December 2013, provided in response to Staff DR BAB-3.5.

Column [B]: Column [A] / Line 4.

Column [C]: From the 2013 annual reports. Staff used the annual reports as it is the most recent, consistently prepared data for all three companies.

Column [D]: Column [C] / Line 4.

Column [E]: From the 2013 annual reports. Staff used the annual reports as it is the most recent, consistently prepared data for all three companies.

Column [F]: Column [E] / Line 4.

Column [G]: From the 2013 annual reports. Staff used the annual reports as it is the most recent, consistently prepared data for all three companies.

Column [H]: Column [G] / Line 4.

Column [I]: Average of Columns [B, D, F, and H].

STAFF ADJUSTMENTS (Cont.) - PROPERTY TAXES

Line No.	Description	Staff Recommended
1	Staff Adjusted Test Year Revenues	\$166,587
2	Weight Factor	2
3	Subtotal (Line 1 * Line 2)	\$333,173
4	Staff Recommended Revenue	166,587
5	Subtotal (Line 4 + Line 5)	\$499,760
6	Number of Years	3
7	Three Year Average (Line 5 / Line 6)	\$166,587
8	Department of Revenue Multiplier	2
9	Revenue Base Value (Line 7 * Line 8)	\$333,173
10	Plus: 10% of CWIP	0
11	Less: Net Book Value of Licensed Vehicles	0
12	Full Cash Value (Line 9 + Line 10 - Line 11)	\$333,173
13	Assessment Ratio	18.00%
14	Assessment Value (Line 12 * Line 13)	\$59,971
15	Composite Property Tax Rate - Obtained from ADOR	11.8636%
16	Staff Test Year Adjusted Property Tax Expense (Line 14 * Line 15)	
17	Company Proposed Property Tax	
18	Staff Test Year Adjustment (Line 16 - Line 17)	
19	Property Tax - Staff Recommended Revenue (Line 14 * Line 15)	\$7,115
20	Staff Test Year Adjusted Property Tax Expense (Line 16)	4,239
21	Increase in Property Tax Due to Increase in Revenue Requirement	\$2,876
22	Increase in Property Tax Due to Increase in Revenue Requirement (Line 21)	\$2,876
23	Increase in Revenue Requirement	\$67,341
24	Increase in Property Tax Per Dollar Increase in Revenue (Line 22 / Line 23)	4.27%

REFERENCES:

Line 15: Composite Tax Rate obtained from Arizona Department of Revenue
Line 21: Line 19 - Line 20

RATE DESIGN			
Monthly Usage Charge	Present Rates	Company Proposed Rates	Staff Recommended Rates
5/8" x 3/4" Meter	\$16.19	\$33.00	\$27.30
3/4" Meter	24.29	49.50	43.80
1" Meter	40.48	82.50	76.80
1½" Meter	80.95	165.00	159.30
2" Meter	129.52	264.00	258.30
3" Meter	242.85	528.00	522.30
4" Meter	404.75	825.00	819.30
6" Meter	809.50	1,650.00	1,644.30
Commodity Rates			
<u>5/8 x 3/4" & 3/4" Meter - Residential</u>			
Gallons Included in Minimum	0	0	0
Excess of Minimum - per 1,000 Gallons			
Per 1,000 Gallons	\$3.50		
First 4,000 Gallons		\$3.75	
From 4,001 to 10,000 Gallons		4.70	
Over 10,000 Gallons		5.55	
t			\$4.50
From 2,001 to 8,000 Gallons			6.40
Over 8,000 Gallons			7.69
<u>3/4" Meter - Commercial & Industrial</u>			
Gallons Included in Minimum	0	0	0
Excess of Minimum - per 1,000 Gallons			
Per 1,000 Gallons	\$0.00		
First 4,000 Gallons		\$0.00	
From 4,001 to 10,000 Gallons		0.00	
Over 10,000 Gallons		0.00	
First 2,000 Gallons			\$4.50
From 2,001 to 8,000 Gallons			6.40
Over 8,000 Gallons			7.69
<u>1" - Residential, Commercial & Industrial</u>			
Gallons Included in Minimum	0	0	0
Excess of Minimum - per 1,000 Gallons			
First 20,000 Gallons	\$0.00	\$0.00	\$6.40
Over 20,000 Gallons	0.00	0.00	7.69
<u>1½" - Residential, Commercial & Industrial</u>			
Gallons Included in Minimum	0	0	0
Excess of Minimum - per 1,000 Gallons			
First 50,000 Gallons	\$0.00	\$0.00	\$6.40
Over 50,000 Gallons	0.00	0.00	7.69
<u>2" - Residential, Commercial & Industrial</u>			
Gallons Included in Minimum	0	0	0
Excess of Minimum - per 1,000 Gallons			
First 80,000 Gallons	\$0.00	\$0.00	\$6.40
Over 80,000 Gallons	0.00	0.00	7.69

RATE DESIGN Con't			
<u>3" - Residential, Commercial & Industrial</u>			
Gallons Included in Minimum	0	0	0
Excess of Minimum - per 1,000 Gallons			
First 150,000 Gallons	\$0.00	\$0.00	\$6.40
Over 150,000 Gallons	0.00	0.00	7.69
<u>4" - Residential, Commercial & Industrial</u>			
Gallons Included in Minimum	0	0	0
Excess of Minimum - per 1,000 Gallons			
First 300,000 Gallons	\$0.00	\$0.00	\$6.40
Over 300,000 Gallons	0.00	0.00	7.69
<u>6" - Residential, Commercial & Industrial</u>			
Gallons Included in Minimum	0	0	0
Excess of Minimum - per 1,000 Gallons			
First 500,000 Gallons	\$0.00	\$0.00	\$6.40
Over 500,000 Gallons	0.00	0.00	7.69

Service Line and Meter Installation Charges	Present Rates			Company Proposed Rates			Staff Recommended Rates		
	Service Line	Meter Charge	Total Charge	Service Line	Meter Charge	Total Charge	Service Line	Meter Charge	Total Charge
5/8" x 3/4" Meter	\$0	\$0	\$430	\$0	\$0	\$430	\$415	\$105	\$520
3/4" Meter	0	0	480	0	0	480	415	205	620
1" Meter	0	0	550	0	0	550	465	265	730
1½" Meter	0	0	775	0	0	775	520	475	995
2" Meter	0	0	1,305	0	0	1,305	800	995	1,795
3" Meter	0	0	1,815	0	0	1,815	1,015	1,620	2,635
4" Meter	0	0	2,860	0	0	2,860	1,430	2,570	4,000
6" Meter	0	0	5,275	0	0	5,275	2,150	4,925	7,075
Service Charges									
Establishment			\$25.00			\$25.00			\$25.00
Establishment (After Hours)			35.00			35.00			0.00
Reconnection (Delinquent)			20.00			20.00			20.00
Reconnection (After Hours)			30.00			30.00			0.00
After-Hours Service Charge			0.00			0.00			35.00
Meter Test (If Correct)			20.00			25.00			25.00
Deposit		*			*			*	
Deposit Interest		*			*			**	
Re-Establishment (Within 12 Months)		**			**			****	
NSF Check			17.50			17.50			17.50
Deferred Payment			1.5%			1.5%			***
Late Payment Penalty			1.5%			1.5%			***
Meter Re-Read (If Correct)			10.00			25.00			25.00

* Per Commission Rule A.A.C. R-14-2-403(B)(7).
** Per Commission Rule A.A.C. R-14-2-403(B)(3).
*** 1.50% of unpaid monthly balance.
**** Month off system times the monthly minimum A.A.C. R14-2-403(D).

In addition to the collection of regular rates, the utility will collect from its customers a proportionate share of any privilege, sales, use, and franchise tax. Per commission rule A.A.C. 14-2-409D(5).

Navajo Water Company
W-03511A-14-0304
Test Year Ended June 30, 2014

Supplemental Schedule BAB-5

TYPICAL BILL ANALYSIS
General Service 5/8 X 3/4 - Inch Meter

Average Number of Customers: 305

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	3,044	\$26.85	\$44.42	\$17.57	65.4%
Median Usage	1,761	\$22.35	\$39.60	\$17.25	77.2%
<u>Staff Recommend</u>					
Average Usage	3,044	\$26.85	\$42.98	\$16.13	60.1%
Median Usage	1,761	\$22.35	\$35.22	\$12.87	57.6%

Present & Proposed Rates (Without Taxes)
General Service 5/8 X 3/4 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Recommended Rates</u>	<u>% Increase</u>
0	\$16.19	\$33.00	103.8%	\$27.30	68.6%
1,000	19.69	36.75	86.6%	31.80	61.5%
2,000	23.19	40.50	74.6%	36.30	56.5%
3,000	26.69	44.25	65.8%	42.70	60.0%
4,000	30.19	48.00	59.0%	49.10	62.6%
5,000	33.69	52.70	56.4%	55.50	64.7%
6,000	37.19	57.40	54.3%	61.90	66.4%
7,000	40.69	62.10	52.6%	68.30	67.9%
8,000	44.19	66.80	51.2%	74.70	69.0%
9,000	47.69	71.50	49.9%	82.39	72.8%
10,000	51.19	76.20	48.9%	90.08	76.0%
15,000	68.69	103.95	51.3%	128.53	87.1%
20,000	86.19	131.70	52.8%	166.98	93.7%
25,000	103.69	159.45	53.8%	205.43	98.1%
50,000	191.19	298.20	56.0%	397.68	108.0%
75,000	278.69	436.95	56.8%	589.93	111.7%
100,000	366.19	575.70	57.2%	782.18	113.6%
125,000	453.69	714.45	57.5%	974.43	114.8%
150,000	541.19	853.20	57.7%	1,166.68	115.6%
175,000	628.69	991.95	57.8%	1,358.93	116.2%
200,000	716.19	1,130.70	57.9%	1,551.18	116.6%